Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	
Universal Service	)	WC Docket No. 05-337
	)	
High-Cost Universal Service Support	)	

REPLY COMMENTS OF VERIZON AND VERIZON WIRELESS

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I. INTRODUCTION AND SUMMARY

This proceeding presents an opportunity to achieve meaningful, long-term reform that should not be missed. The sheer number of commenters in this matter, more than 50 strong, signals that broad-based changes in the telecommunications marketplace are challenging all market participants to adapt. Carrier responses to these marketplace changes – such as strong, new intermodal competition – already include adopting new technologies, streamlining to improve efficiency, structural adjustments such as consolidation, partnerships, and alliances, and the development of additional revenue from new services to replace traditional service revenue lost to competition.

As is clear from many of the industry comments, the universal service mechanism must also now adapt to a competitive landscape that looks vastly different from the telecommunications environment at the time the 1996 Act was adopted. The current system of high cost subsidies is based on a model of service delivery that may not be viable in the long-

1 The Verizon companies participating in this filing are the regulated, wholly owned subsidiaries of Verizon Communications Inc.

term. More than ever before, telecommunications consumers have options – especially from new offerings by cable, VoIP, and wireless providers – and they are taking advantage of them.

To adjust, the Joint Board and the Commission must fundamentally change the course of universal service policy and find more efficient, market-oriented ways to meet the requirements of the Act. This starts with targeting high cost funds to areas where they are truly needed to ensure affordable access. It also means selecting the most efficient carriers to provide supported services for the least amount of subsidy. And most important, it means creating an environment that promotes innovation and efficiency gains by all service providers in all areas. With the right design, competitive bidding can help advance these necessary objectives.

II. THERE IS WIDESPREAD AGREEMENT THAT COMPREHENSIVE REFORM OF THE HIGH COST FUND IS CRITICAL, AND REVERSE AUCTIONS CAN SERVE AS A PRO-CONSUMER SOLUTION TO MANY OF THE FUND'S PROBLEMS.

Most commenters agree that the current system of high cost support is broken, so much so that the Joint Board and the Commission must undertake serious and comprehensive reform efforts. A piecemeal approach laden with temporary measures designed to address specific problems will not accomplish this goal. The competitive landscape has changed too much and the strains on the fund have grown too great. The time is now for the Joint Board and the Commission to focus on meaningful, long-term solutions that will advance, not detract from, core universal service goals.

Many wireless carriers and other commenters correctly point out that the current system of subsidy distribution to all ETCs operating in a high cost area is based on antiquated funding models tied to the embedded costs of the high cost incumbent.[2] This is neither sustainable nor warranted. Demand for traditional wireline phone service is now declining in all parts of the

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[2] *See, e.g.,* CTIA Comments at ii, 3; Dobson Cellular Comments at 2.

country as cable, VoIP, and wireless providers roll out new products.[3] As this trend continues, and likely accelerates, embedded per-line costs of incumbents will increase. Since there is no meaningful cap on high cost subsidies,[4] incumbents lack incentives to adapt and create new efficiencies, meaning further strain on the fund with no commensurate increase in service to customers can be expected.

In addition, many rural incumbent carriers and other commenters correctly point out that the current system encourages duplicative networks that are not necessary to satisfy universal service goals.[5] Indeed, the number of CETCs that receive high cost subsidies has increased dramatically over the last several years.[6] And the Commission's portability rules ensure that all ETCs, regardless of their efficiency, in every high cost area receive funding at the same per-line level as the incumbent. 47 C.F.R. § 54.307. Universal service is designed to ensure that all Americans have affordable access to telecommunications service. 47 U.S.C. § 254(b). The build-out of vast competitive voice service networks is not, and should not be, the driver of universal service policy. Still, some commenters overstate the role of CETCs in contributing to the fund's instability, and while it is an important component of reform, solely limiting subsidies

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3 *See* Industry Analysis and Technology Division Wireline Competition Bureau, *Local Telephone Competition: Status as of December 31, 2005*, at Table 1 (July 2006) (showing steady decline in end-user switched access lines from Dec. 2000 to Dec. 2005); *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Eleventh Report, FCC 06-142, ¶ 215 (Sept. 29, 2006) (noting that "consumers appear increasingly to cho[o]se wireless service over traditional wireline service").

4 While there is a cap on the High Cost Fund, it applies only to ILECs and not to CETCs.

5 *See* Telecom Consulting Associates Comments at 8; Fairpoint Communications Comments at 7; USTA Comments at 15 ("[T]he current system supports multiple networks in areas where market-based competition cannot even support a single network. . .")

6 In less than five years, the share of high cost funds spent to subsidize CETCs in high cost areas increased from 0.1 percent to 9.5 percent. FCC, Industry Analysis & Technology Division, Wireline Competition Bureau, *Trends in Telephone Service, Table Compiled as of April 2005*, at Table 19.5 (June 21, 2005); *see also* Comments of OPASTCO, CC Docket No. 96-45 (Sept. 30, 2005).

to CETCs will not solve the larger problems.[7] Only 9.5 percent of all high cost subsidies flow to CETCs.[8] At the same time, wireless carriers contributed nearly $2.3 billion to the universal service fund in 2005.[9] And as a group, given the Commission's recent increase in the wireless safe harbor, wireless carriers may well become the largest contributors to universal service in 2006.[10]

The problems endemic to the High Cost Fund and the current system of high cost subsidies are layered and many.[11] Most commenters agree that the High Cost Fund is too big[12] – increasing to about $4 billion per year[13], more than double the size of the fund just seven years ago.[14] But the fund's size is merely a symptom of the larger problem: the absence of a mechanism that effectively imposes market-force controls (driven by consumer preferences) on high cost subsidies. A properly structured system of competitive bidding for high cost dollars can help bridge that gap.

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7 *See, e.g.,* ITTA Comments at 20-26; OPASTCO Comments at ii, 6-13.

8 *Trends in Telephone Service*, at Table 19.5.

9 *See* Alltel Ex Parte Presentation, CC Docket No. 96-45 (Oct. 20, 2006) at Attach. at 12.

10 *Id.*

11 *See, e.g.,* USTA Comments at 15-17.

12 *See, e.g.,* Qwest Comments at 3 (urging the Commission to stop and reverse the trend of fund growth); Missouri PSC Comments at 1 (noting "widespread agreement" that the fund is strained and supporting "efforts to reform and stabilize the fund."); Verizon and Verizon Wireless Comments at 12.

13 USAC, *Federal Universal Support Mechanisms Fund Size Projections for the Fourth Quarter 2006*, App. HC02 (2006) (unaudited), http://www.universalservice.org/about/governance/fcc-filings/2006.

14 USAC, *Universal Service Fund Facts-High Cost Program* Data, 1998-2005 Disbursements by *Calendar Year* (2005) (unaudited), http://www.universalservice.org/about/universal-service/fund-facts/fund-facts-high-cost-program-data.aspx#calendar.

Commenters recognize that consumers stand to benefit from a more efficient distribution of high cost support among providers and that auctions "could minimize the burden on customers providing the support" in the form of USF payments. *Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support,* Public Notice, 21 FCC Rcd 9292, 9294, ¶ 4 (Aug. 11, 2006). Many commenters rightly see reverse auctions as a potentially pro-consumer "step in the right direction." NJBPU Comments at 3-4.

For example, the Seniors Coalition explains that an auction mechanism will reduce waste in fund distribution and therefore could result in a reduction in the contribution factor, "and thereby increase access to [service] by low- and fixed-income consumers." Seniors Coalition Comments at 4. Inviting carriers to bid for high cost support also "has the potential to inject more competition into the marketplace and that could lead to more efficient service provision resulting in less costs for consumers." American Association of People with Disabilities Comments at 2. Moreover, an appropriately designed reverse auction mechanism "would achieve th[e] all-important objective" of "ensur[ing] that the ultimate beneficiaries of the USF high cost support are the consumers who need that support." TracFone Comments at 7.

III. APPROPRIATE FINANCIAL STABILITY AMONG INCUMBENTS WOULD BE MAINTAINED BY COMPETITIVE BIDDING FOR HIGH COST SUPPORT.

Some commenters seem to suggest that reverse auctions would spell the end for the high cost incumbents, particularly those operating in rural areas.[15] NECA even suggests that competitive bidding for high cost support would in a single swoop eliminate decades-old rate of

[15] *See* ICORE Companies Comments at 1 (claiming competitive bidding would "destroy the financial viability" of rural ILECs); NTCA Comments at 3; OPASTCO Comments at ii ("The use of reverse auctions in rural service areas would jeopardize [ILECs'] record of success."); Alexicon Telecommunications Consulting Comments at 5 (predicting that reverse auctions could leave rural areas "without a service provider or cause reduced service capabilities compared to existing ILECs."); CoBank Comments at 2; RTFC Comments at 1.

return regulatory regimes and otherwise threaten the "special status" of ILECs.[16] It is understandable that the disruption and change associated with reform of high cost distributions is unsettling to those parties that have long received sizable subsidies. But there is no reason to believe that the sky would fall if the Joint Board and the Commission move to a system of competitive bidding for high cost subsidies. Market forces are already creating disruption and change. Doing nothing is no longer an option, since the fund cannot, and should not, be sustained in its present form. To the extent the current universal service mechanisms inhibit adaptation by rural carriers, attempting to maintain them in their current form will do nothing to enhance the long-term prospects for those carriers, or for their customers.

Implementation of a system of competitive bidding need not be done by flash cut. After a separate analysis to determine where competition has taken hold without universal service support and where high cost subsidies are truly needed to ensure affordable access, the Joint Board and the Commission should target further subsidies only to those areas. Many of the remaining high cost areas would then be ripe for competitive bidding to select the most efficient carrier(s) capable of providing supported services for the lowest amount of support necessary to ensure affordable access. Even then, however, a fair transition period may be appropriate. As Verizon and Verizon Wireless suggested in their initial comments, one way to provide for the transition would be to recognize two reverse auction "winners" – the low bidder and the incumbent – in appropriate high cost areas for a period of time during which subsidies to the incumbent would be reduced to the CETC level (if lower) before fully transitioning to a one-

[16] *See* NECA Comments at i, 2, 8-12. This comment is as misleading as it is puzzling. The Commission's rate of return regulatory regime serves a purpose different from universal service. Congress did not create the Universal Service Fund to ensure that rate of return carriers enjoy a robust return, nor to grant them a special status. As Verizon and Verizon Wireless have proposed, a transition period sufficient to give incumbents time to adjust is appropriate in some high cost areas, but meaningful reforms must move forward.

winner system. As many commenters suggest, the 10-year transition period that the model proposal attached to the Joint Board's Public Notice in this matter is too long,[17] but there should be a reasonable compromise.

A transition period would give ILECs time to adjust to the more competitive marketplace. It is important to note that such competitive adjustments will be required irrespective of whether the Joint Board and the Commission act on reverse auctions. Ultimately, the technological and other preferences of consumers will drive next-generation voice services – not high cost subsidies, no matter the size. After an appropriate transition period, it is true that an ETC could lose the bid to provide supported services, and support could go to another ETC. Nonetheless, ILECs will have the same opportunity as all ETCs in a high cost area to compete for and win the bid.

IV. REVERSE AUCTIONS SATISFY STATUTORY REQUIREMENTS.

There is no merit to the hypothetical concerns raised by a number of commenters regarding the Joint Board and the Commission's legal authority to implement a system of competitive bidding for high cost support.

A. Section 254 Requirements Are Designed To Serve Consumers, Not Carriers.

Commenters that question the legality of an auction mechanism overlook the fact that universal service "is to benefit the customer, not the carrier." *Alenco Comm'ns v. FCC*, 201 F.3d 608, 621 (5th Cir. 2000). As a result, TDS's directive, for instance, that the Commission address statutory requirements "from the perspective of both the public and individual service providers, since both entities have a need for predictable support," reflects the wrong analysis. TDS

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17 *See, e.g.,* RCA Comments at ii, 10; Missouri PSC Comments at 7; NTCH Comments at 9; Alltel Comments at 4.

Comments at 9. Viewing statutory requirements from the consumer's perspective, as Congress intended, allays challenges to the legality of reverse auctions.

The Act requires "sufficient" and "predictable" support, *not* subsidies that are constant and indefinite. 47 U.S.C. § 254(b)(5). One of the primary benefits of competitive bidding is that the sufficiency of funding levels is knowable from the bidding process itself. It is ETCs – not regulators – that have the best knowledge of their own costs and revenues. In that respect, no rational ETC participant in a reverse auction would submit a bid for a level of support insufficient to actually provide the supported services.

Similarly, arguments such as those advanced by Oklahoma Carriers that auctions would "undercut[] the predictability of how much support, if any, would be available in a particular market" simply miss the point. Oklahoma Carriers Comments at 4; *see also* CenturyTel Comments at 21 (claiming that "support levels [that] vary by auction period and [are] determined by the lowest bidder" will be neither sufficient nor predictable); GVNW Consulting Comments at 3. The Act requires only that the mechanism for determining support be predictable, not the amount of support that is distributed in each market. *Alenco*, 201 F.3d at 622 ("What petitioners seek is not merely predictable funding mechanisms, but predictable market outcomes. Indeed, what they wish is protection from competition, the very antithesis of the Act."). In any event, "[s]ince the bid amount would be known before funds were distributed and service provided, the amount of support. . .would be entirely predictable." TracFone Comments at 4.

Moreover, in establishing the fund Congress did not create a protected class of carriers. Universal service is not designed to subsidize "the unavoidable high costs of small, rural ILECs" as ICORE Companies mistakenly asserts (at 6); it is to ensure that consumers in all parts of the country have access to affordable service. On this point the Missouri PSC gets it exactly right, observing that, under the Act, universal service must be targeted to those *areas*, not those *carriers*, that need support.[18] It is entirely appropriate to shift high cost subsidies between providers to better reflect consumers' technological preferences and to achieve the most efficient method of providing supported services to all consumers.

B. Competitive Bidding Is Consistent With *Smith v. Illinois Bell.*

The Rural USF Coalition improperly contends that *Smith v. Illinois Bell* poses an obstacle to a reverse auction mechanism.[19] *Smith* has no bearing on high cost distributions in this context. In *Smith*, the Supreme Court struck down a decision of the Illinois Commerce Commission setting a carrier's rates based on costs but without making a distinction between intrastate and interstate property and business of the carrier. *Smith,* 282 U.S. at 146-47. *Smith* requires only that regulators relying on costs set rates at levels sufficient to recover the costs assigned to their jurisdictions; *Smith* does not dictate the appropriate method of regulation by the Commission or any state. There is no connection between the Rural USF Coalition's concern regarding the potential under-recovery of costs under a particular recovery mechanism – *e.g.*, competitive bidding – and the jurisdictional allocation of costs in ratemaking.[20] *Smith* is irrelevant to the statutory and other legal concerns at issue here.

C. Carrier Of Last Resort Obligations Can Be Addressed Through Auction Rules And Section 214(e) Relinquishment Procedures.

Various commenters cite the ILECs' carrier-of-last-resort ("COLR") obligations as obstacles to any successful competitive bidding system. CenturyTel, for example, complains

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18 Missouri PSC Comments at 6.

19 *See* Rural USF Coalition Comments at 7 (citing *Smith v. Ill. Bell Tel. Co.*, 282 U.S. 133 (1930)).

20 Rural USF Coalition Comments at 7.

that losing bidders might be forced to raise rates to comply with COLR obligations[21], and the Oklahoma Corporation Commission worries that COLR obligations could "result[] in confusion" under an auction mechanism. OCC Comments at 6. In reality, however, auction rules, in conjunction with existing regulations, can address COLR concerns.

The auction mechanism can be structured in such a way that would make the winning bidder the COLR, with all attendant obligations.[22] As AT&T explains, COLR responsibility would be entirely consistent with anticipated representations or certifications by bidders (made or executed prior to the submission of bids) that if selected as the auction winner they will "receive[] sufficient support to be able to offer supported services to all customers in that geographic area at an affordable rate." AT&T Comments at 15.

Just as a winning bidder could assume COLR duties, any losing bidder that is a COLR can be relieved of those obligations as provided in Section 214(e). Section 214(e) "provides that a state must permit an ETC (such as an ILEC) to relinquish its designation as an ETC for a particular area within one year if another ETC serves that area and undertakes the [C]OLR obligation." AT&T Comments at 16; *see also* NASUCA Comments at 7-8. Multiple commenters correctly note that an ILEC that does not win the bid to provide supported services in a particular high cost area should indeed be relieved of its COLR responsibilities.[23]

V. CAREFUL ATTENTION TO THE DETAILS OF THE AUCTION MECHANISM WILL BE REQUIRED.

In order to be successful, any new system of competitive bidding will require careful consideration of all important details. This is inevitable. But this is not a reason to forgo

21 CenturyTel Comments at 20.

22 *See, e.g.,* ACS Comments at 3-4; Qwest Comments at 8.

23 *See, e.g.,* AT&T Comments at 16; Qwest Comments at 8; OPASTCO Comments at 20-21; Texas Statewide Telephone Cooperative Comments at 11-12.

worthwhile reform. The prospect of using auctions to assign spectrum rights also seemed daunting more than a decade ago. Yet today there can be little doubt that auctions provide an efficient, market-based measure of spectrum value. Competitive bidding is the most widely accepted method for governments to procure a wide range of goods and services – including those that involve many of the same concerns raised by commenters, such as quality assurance and the potential for stranded investments.

A. Quality Of Service Concerns Are Not Unique To Competitive Bidding.

Quality of service concerns are addressed adequately under the Commission's existing rules and are not unique to the auction process. As NCTA recognizes, the existing universal service mechanism "establish[es] the minimum level of service to be offered and obligations that must be met by all bidders." NCTA Comments at 5. The reverse auction mechanism would presumably only be open to ETCs, which by definition already have demonstrated to the satisfaction of a state board or the Commission that they are capable of offering, and in fact do offer, supported services in a high cost area. *See* 47 U.S.C. § 214(e)(1)(A). ETCs that win the bid to provide supported services will also have natural, market-based incentives to provide high quality services to prevent churn, especially given the recent rise in intermodal competition and the presence of many providers that operate in high cost areas with no universal service support.

Commenters that claim the competitive bidding process would engender a "race to the bottom" are off base.[24] GVNW Consulting, for example, suggests that service quality would suffer because carriers who win the bid would offer services at a *lower* cost than their bids and hold onto additional profits.[25] Other commenters posit the opposite – that costs will trend *higher*

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[24] *See, e.g.*, GVNW Consulting Comments at 11; NASUCA Comments at 6; CenturyTel Comments at 13.

[25] GVNW Consulting Comments at 11-12.

than what ETCs will telegraph in their bids and that carriers who win the bid may be unable to provide supported services.[26] This is unsubstantiated rhetoric. As the Joint Board has already observed, "the question of quality standards is not unique to competitive bidding," and "competition will give carriers the incentive to provide quality service" at the rational amount of their bids. *Federal-State Joint Board on Universal Service,* Recommended Decision, 12 FCC Rcd 87, 267, ¶ 346 (1996) ("*First Recommended Decision*").

B. Subsidizing More Than One ETC In A High Cost Area After An Appropriate Transition Period Is A Mistake.

Commenters disagree on the number of ETCs that should be funded by the auction mechanism. Some parties support use of an auction mechanism to establish support levels in high cost areas, but then favor continuing to fund all ETCs at the auctioned amount.[27] Others suggest that to maximize the benefits of reverse auctions no more than one ETC should ultimately be selected to provide supported services in those remaining high cost areas where subsidies are truly necessary to ensure affordable access.[28] It would be a mistake to ultimately fund more than one ETC in any high cost area.

As discussed above, an appropriate transition period may require funding two auction "winners" in some high cost areas to allow existing recipients time to adjust and to compete head-on with all CETCs. After the transition, however, there is no need nor compelling reason

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[26] *See* CenturyTel Comments at 15-16; NTCA Comments at 7.

[27] *See* Alltel Comments at 3, 6; Dobson Cellular Comments at 5-6; General Communication Comments at 3 ("[T]he auction procedure should allow for more than one carrier to receive the winning per-line support amount to the extent that more than one provider is willing to provide the supported services at the winning bid amount."). This approach would diminish the incentives for each ETC to bid aggressively, since each ETC would know that it could not be excluded, no matter how high it bid.

[28] *See* AT&T Comments at 12; Missouri PSC Comments at 2; TracFone Comments at 10; Verizon and Verizon Wireless Comments at 25-26.

to spend universal service taxes on efforts to buoy competition in high cost areas. Universal service was not designed to preserve and enhance competition. Commenters who suggest otherwise[29] either misunderstand or misstate Congress' objectives in establishing the fund.

Congress expressly contemplated a system of universal service whereby subsidies could even disappear altogether when no longer necessary to ensure affordable access. "In some areas of the country. . .the Committee expects that support payments would not be needed in order to provide universal service at just, reasonable, and affordable rates. The Committee intends. . .flexibility for the FCC to reduce or eliminate support payments to areas where they are no longer needed. . ." S. Comm. on Commerce, Science, and Transportation, Report on Telecommunications Competition and Deregulation Act of 1995, at 39 (1995).

C. Reverse Auctions Are Appropriate In Both Non-Rural And Rural Areas.

The fund's growth is not limited to non-rural areas and non-rural ETCs.[30] It therefore does not make sense, and would not be an efficient use of regulatory resources, to first focus high cost reform only on non-rural areas, as some suggest.[31] Moreover, to suggest that auctions could only be effective in targeting support to the most efficient providers in non-rural areas reflects a misunderstanding of the sophistication of auction mechanisms.

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29 *See, e.g.*, RCA Comments at 4 (contending that universal service should be used "to drive wireless infrastructure development in rural America"); Dobson Cellular Comments at 6 (arguing that the Act's universal service requirements are met when there is a "vibrant competitive marketplace in rural areas").

30 *See* Federal-State Joint Board on Universal Service, *Universal Service Monitoring Report*, CC Docket No. 96-45, at Table 3.1 (2005) (showing projected 2005 payments of over $1.19 billion for rural carriers under the embedded cost mechanism and $291 million for non-rural carriers under the forward-looking cost model, and an increase in the rural fund of $322 million over five years compared with $72 million in the non-rural fund).

31 *See, e.g.,* OPASTCO Comments at 14-15; GVNW Consulting Comments at 3, 11; Fairpoint Communications Comments at 20; *see also* NECA Comments at ii (arguing that if implemented auctions should not be applied to rate of return carriers).

Foremost, consumers who pay for the fund have the right to expect efficiency from all subsidized carriers regardless of the regions and competitive environments in which they operate. The provision of supported services in rural high cost areas can present unique challenges. But the competitive reality is that traditional phone service is now declining, in some cases rapidly, in all parts of the country. Verizon alone has lost approximately 11 million lines since the end of 2002 – a decrease of 18 percent – and its local subscriber base continues to shrink.[32] Overall, active wireline access lines are declining by more than five percent annually for the larger LECs (*i.e.*, the RBOCs) and by more than three percent annually for the rural LECs.[33] This trend is expected to continue as non-traditional voice service providers make further inroads in both rural and non-rural markets.[34] Consumers in all regions increasingly demand more, or different, voice services. As a result, the Joint Board and the Commission – and indeed carriers themselves – can no longer afford to ignore efficiency concerns, even in rural

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[32] *Compare Verizon Investor Quarterly, Q4 2002* at 13, http://investor.verizon.com/financial/quarterly/vz/4Q2002/4Q02Bulletin.pdf (Jan. 29, 2003); *with Verizon Investor Quarterly, Q2 2006* at 14, http://investor.verizon.com/financial/quarterly/vz/2Q2006/2Q06Bulletin.pdf (Aug. 1, 2006).

[33] NECA, *Trends 2006: Making Progress with Broadband* at 7 (Sept. 2006) ("[B]etween 2003 and 2006 the number of access lines for [NECA's Traffic Sensitive] pool participants declined by a total of 3.3% over the three year period."), http://www.neca.org/media/trends_brochure_website.pdf.

[34] *See, e.g.*, *Verizon Investor Quarterly, Q3 2006* at 14, http://investor.verizon.com/financial/quarterly/vz/3Q2006/3Q06Bulletin.pdf (Oct. 30, 2006) (reporting a loss of 7.5 percent of Verizon's total access lines between the third quarter of 2005 and the third quarter of 2006 and a loss of 9.8 percent of residential access lines in the same period); S. Flannery, *et al.*, Morgan Stanley Research, *2Q06 Preview: Cautious Second Half Outlook in Prospect* at Exh. 15 (July 19, 2006); *see also* Viktor Shvets, *et al.*, Deutsche Bank, *2006 Preview: Out with the Old, In with the New* at 9 (Dec. 19, 2005) ("In 2005, Verizon continued to suffer the highest rate of loss (ending the year at an estimated rate of around 6.7%). We continue to believe that this is primarily caused by its 'cutting edge' exposure to aggressive cable telephony deployments by CVC and Time Warner."); J. Armstrong, *et al.*, Goldman Sachs, *Preview in Pictures (PiP) – 2Q2006* at 2 (July 19, 2006) ("Access line erosion continues to worsen, on average 17 bp worse than last quarter. Average line loss from the RBOCs should be 6.5%, with VZ line erosion reaching 7.0%.").

areas. Auctions or no auctions, carriers in all parts of the country need to adapt to new consumer demands.

Moreover, with the right design reverse auctions can help drive efficiency in both rural and non-rural areas. Commenters correctly point out that many high cost areas have only one or very few ETCs.[35] This does not mean, however, that auctions cannot be used to set support amounts in these areas at the most efficient level. It will not likely ever be practical or necessary for the Joint Board and the Commission to auction all support in every high cost area. The administrative burden in doing so would alone likely be prohibitive. But high cost areas are just not that unique. The Joint Board and the Commission can look to areas that are auctioned and use models drawing on common market facts that drive the cost of providing supported services to determine appropriate subsidy levels in areas that are not auctioned. Economic modeling is an established practice. With active participation from all interested constituents and auction theory experts, it can work in this context.

VI. STATE UTILITIES BOARDS AND THE COMMISSION WOULD PLAY THE SAME ROLES IN DESIGNATING ETCS.

Some commenters express concern about the role of state commissions in a system of competitive bidding. As commenters request, the competitive bidding process should preserve "an important role for state commissions in the designation of carriers eligible to receive universal service support . . .as state commissions are in the best position to review the public interest standards surrounding requests for ETC designation." Missouri PSC Comments at 4; *see also* Texas PUC Comments at 6; Alltel Comments at 5. The current joint process in which ETCs

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35 *See, e.g.*, USAC, *Fourth Quarter Appendices – 2006,* at HC03 (Rural Study Areas with Competition) & HC05 (High Cost Loop Support Projected by State by Study Area) (of the approximately 1,300 incumbent rural study areas eligible for high cost loop support, 39 percent do not have a CETC, and 24 percent have only one CETC), http://www.universalservice.org/about/governance/fcc-filings/2005.

are designated by both the Commission and state utilities boards should be maintained. The ETC designation procedure could function as part of the "bidder qualification" process. The Commission could then promulgate nationwide auction rules, in coordination with state boards, which would eliminate concerns over a "hodge-podge of potentially overlapping/conflicting rules and eligibility standards for high-cost recovery." Alexicon Comments at 7.

Commenters that suggest using reverse auctions to merely qualify carriers *for* ETC status, however, miss the point.[36] As Verizon and Verizon Wireless explained in their initial comments, ETC designation by state commissions would, as the name suggests, make providers *eligible* for support, but would not *guarantee* a particular level of support.[37] Thus, ETC designation would be a prerequisite to participating in competitive bidding. The understanding that an ETC would have to win the bid to provide supported services in a high cost area before being funded should also minimize concerns raised by commenters regarding delays in the current ETC designation process.[38]

VII. THERE IS EVERY REASON TO BELIEVE THAT REVERSE AUCTIONS CAN BE SUCCESSFUL.

It was predictable that the Joint Board's Public Notice in this matter would result in both optimism and apprehension among commenters. Using reverse auctions to determine high cost support would constitute a real change in universal service policy. But, as discussed throughout, fundamental change is occurring right now and change in universal service policy is inevitable. In that respect, it is important to focus high cost reform efforts on comprehensive solutions that

36 *See, e.g.,* NTCH Comments at 3 ("Upon 'winning' the reverse auction, the bidding carrier would automatically have ETC status without further ado.").

37 *See* Verizon and Verizon Wireless Comments at 19 (citing *First Recommended Decision,* 12 FCC Rcd at 267, ¶ 345).

38 *See* NTCH Comments at 3; TracFone Comments at 12.

can have a meaningful, long-term impact. With the right design, reverse auctions can have such an impact.

Several commenters correctly observe that auctions are hardly a unique way to allocate assets to those in the best position to make the most efficient use of them, especially in the government context. TracFone, for example, points out that reverse auctions and economic modeling are common commercial valuation mechanisms, particularly in government procurement.[39] Satellite Industry Association highlights the use of reverse auctions to determine appropriate, market-oriented subsidy levels in the provision of telecommunications services in multiple South American countries, India, and South Africa.[40] And in addition to the Commission's successful and largely efficient spectrum auctions, Verizon and Verizon Wireless note that auctions are used in many different industries to assign market value – even including the Canadian timber industry.[41] There is every reason to believe that reverse auctions can help fix the problems endemic to the broken system of high cost distributions.

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39 TracFone Comments at 10-11 (explaining that when a government entity seeks to purchase goods or services, it does not simply purchase from a single incumbent vendor at historical costs, but rather accepts competing bids).

40 SIA Comments at 4 (explaining that these programs have been successful at "driving financial support down to more efficient levels" due in part to "new entrants utilizing innovative technologies").

41 Verizon and Verizon Wireless Comments at 15-16.

VIII. CONCLUSION

For all of the foregoing reasons, the Joint Board and the Commission should establish an appropriate reverse auction mechanism that targets high cost funding narrowly to the most efficient providers in service areas where subsidies are necessary to ensure affordable access.

Respectfully submitted,

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